

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

AT RICHMOND, APRIL 6, 2007

COMMONWEALTH OF VIRGINIA, ex rel.

STATE CORPORATION COMMISSION

SECRET CONTROL

2007 APR -6 A 11:42

Ex Parte: In the matter of
Adopting a Revision to the Rules
Governing the Virginia Retail Franchising Act

CASE NO. SEC-2007-00016

ORDER TO TAKE NOTICE

Section 12.1-13 of the Code of Virginia provides that the State Corporation Commission ("Commission") shall have the power to promulgate rules and regulations in the enforcement and administration of all laws within its jurisdiction. Section 13.1-572 of the Virginia Retail Franchising Act ("Franchising Act"), § 13.1-559 *et seq.* of the Code of Virginia provides that the Commission may issue any rules and regulations necessary or appropriate for the administration and enforcement of the Franchising Act.

The rules and regulations issued by the Commission pursuant to the Franchising Act are set forth in Title 21 of the Virginia Administrative Code. A copy also may be found at the Commission's website: <http://www.scc.virginia.gov/division/srf>.

The Division of Securities and Retail Franchising ("Division") has submitted to the Commission a proposed revision to Chapter 110 of Title 21 of the Virginia Administrative Code entitled "Virginia Retail Franchising Act Rules," which adds new rules 21 VAC 5-110-65 and 21 VAC 5-110-75.

The proposed revisions add new sections to the franchising rules to address statutory changes made during the 2007 legislative session. The first section of revisions provides for alternative methods of complying with the financial requirements for applicants for registration

and renewal of franchises. Proposed new Section 21 VAC 5-110-65 provides for escrow and deferral of franchise fees, including all of the requirements for complying with the new rules and any forms necessary to complete compliance. The second section of revisions provides for terms and conditions for a franchisor to request an exemption from the registration requirements of the Franchising Act or comply with a self-executing exemption. Proposed new Section 21 VAC 5-110-75 describes the terms and conditions for a franchisor to request an exemption from registration of the Franchising Act or comply with a self-executing exemption, including the required filing fee and any forms necessary to complete the application for exemption process.

The Division has recommended to the Commission that the proposed revisions be considered for adoption with an effective date of July 1, 2007. The Division also has recommended to the Commission that a hearing should be held, if requested by those interested parties who wish to comment with regard to the proposed rules, to consider the proposed revisions on May 29, 2007.

A copy of the proposed revisions may be requested by interested parties from the Division by telephone, by mail or e-mail request and also can be found at the Division's website: <http://www.scc.virginia.gov/division/srf>. Any comments to the proposed rules must be received by May 16, 2007.

IT IS THEREFORE ORDERED that all interested persons TAKE NOTICE that:

(1) The Commission shall conduct a hearing, if necessary, in the Commission's Courtroom, 2nd Floor, Tyler Building, 1300 East Main Street, Richmond, Virginia 23219 at 10 a.m. on May 29, 2007, to consider the adoption of the revisions proposed by the Division with an effective date of July 1, 2007.

(2) On or before May 16, 2007, any interested person desiring to comment in support of or in opposition to the proposed revisions shall file comments in writing with the Clerk of the Commission, Document Control Center, P. O. Box 2118, Richmond, Virginia 23218.

(3) On or before May 16, 2007, any interested person intending to appear and be heard at the hearing on the proposed revisions shall file written notice of his intention to do so, which notice shall include his comments in support of or in opposition to the proposed revisions, with the Clerk of the Commission at the address set forth in the preceding paragraph. If no person files a timely written notice of intention to appear at the hearing on May 29, 2007, the hearing may not be held.

(4) All filings made under paragraph (2) or (3) shall contain a reference to Case No. SEC-2007-00016.

(5) The Commission's Division of Information Resources shall cause a copy of this Order, together with proposed revisions, to be forwarded to the Virginia Registrar of Regulations for the appropriate publication in the Virginia Register of Regulations.

(6) On or before April 30, 2007, the Commission's Division of Information Resources shall make available this Order and the proposed revisions on the Commission's website: <http://www.scc.virginia.gov/caseinfo/orders.htm>.

CHAPTER 110

RETAIL FRANCHISING ACT RULES ~~AND FORMS~~

(a) **21 VAC 5-110-65. Escrow and deferral.**

A. Escrow requirement. The commission may require a franchisor to escrow franchise fees and other payments made by a franchisee until the franchisor's pre-opening obligations under the franchise agreement have been satisfied. The commission may require escrow at any time after the submission of a registration or renewal application and upon a finding that the grounds enumerated in clause (i) of subdivision A 2 of § 13.1-562 of the Act as provided in Chapter 668 of the 2007 Acts of Assembly exist.

B. Depository. Funds subject to an escrow condition shall be placed in a separate trust account with a national bank located in Virginia or a Virginia state chartered bank or trust company.

C. Compliance with escrow requirement. The franchisor shall file with the commission the following to comply with the commission's escrow requirement:

1. An original, fully executed copy of the Escrow Agreement, Form K;
2. A written consent from the depository agreeing to operate the escrow account under this regulation;
3. The name and address of the depository and the account number of the escrow account;
4. The name, address, telephone number and e-mail address of an individual or individuals at the depository who may be contacted by the commission regarding the escrow account; and

5. An amended franchise application reflecting, in Item 5 of the offering circular or in a Virginia Addendum to the offering circular, that the commission has imposed the escrow requirement and the material terms of that escrow condition, including the name of the depository.

D. Operation of escrow account. After the commission imposes an escrow requirement upon the franchisor, the franchisor shall:

1. Make franchisee checks for franchise fees or other payments for the franchisor payable to the depository;

2. Deposit with the depository, within 48 hours of the receipt, the funds described in subdivision D 1; and

3. Deposits made to the depository shall remain escrowed until the commission authorizes the release of the funds.

E. Release of escrowed funds.

1. A franchisor may apply to the commission for the release of escrowed funds.

2. A franchisor's application to the commission to authorize the release of escrowed funds to the franchisor shall be in writing, verified by an authorized officer of the franchisor and shall contain:

a. The franchisor's statement that all proceeds from the grant of franchises have been placed with the depository in accordance with the terms and conditions of the escrow requirement;

b. The depository's statement, signed by an appropriate officer, setting forth the aggregate amount of escrowed funds deposited with the depository and the franchisor's account number with the depository;

c. A list of the names and addresses of each franchisee and the amount held in the escrow account for the account of each franchisee;

d. The amount of funds sought to be released;

e. A written certification from the franchisee stating the amount of funds to be released that acknowledges that the franchisor has completely performed its pre-opening obligations under the franchise agreement, including providing real estate, improvements, equipment, inventory, training, or other items as required by the franchise agreement; and

f. Other information the commission may reasonably require.

3. If the commission finds that the franchisor has fulfilled its obligations under the franchise agreement for a specified franchisee, the commission shall authorize the depository to release to the franchisor the amount held in escrow for the account of the applicable franchisee.

F. Removal of escrow requirement. The commission may remove the escrow requirement at any time, if:

1. The franchisor agrees to defer franchise fees and other initial payments; or

2. Based upon new information, the commission finds that the escrow requirement is no longer necessary and appropriate for the protection of prospective franchisees.

G. Deferral of fees in place of escrow requirement.

1. In lieu of an escrow requirement, the commission may, under appropriate circumstances, accept a franchisor's agreement to defer franchise fees and other initial payments owed by franchisees until the franchisor has completed its pre-opening obligations under the franchise agreement.

2. The franchisor's agreement to defer franchise fees shall be reflected in Item 5 of the offering circular or in a Virginia Addendum to the offering circular.

21 VAC 5-110-75. Exemptions. Any offer or grant of a franchise in a transaction that meets the requirements of this section is exempt from the registration requirement of § 13.1-560 of the Act.

1. Sale or transfer by existing franchisee. The sale or transfer of a franchise by a franchisee who is not an affiliate of the franchisor for the franchisee's own account is exempt if:

a. The franchisee's entire franchise is sold or transferred and the sale or transfer is not effected by or through the franchisor.

b. The sale or transfer is not effected by or through a franchisor merely because a franchisor has a right to approve or disapprove the sale or transfer or requires payment of a reasonable transfer fee.

c. The right to approve or disapprove the sale or transfer shall be exercised in a reasonable manner.

2. Offers and grants to existing franchisees. The offer or grant of an additional franchise to an existing franchisee of the franchisor for the franchisee's own account is exempt if the franchise being sold is substantially the same as the franchise that the franchisee has operated for at least two years at the time of the offer or grant of the franchise, provided the prior sale to the franchisee was pursuant to a franchise offering that was registered pursuant to the requirements of the Act.

3. Seasoned franchisor.

a. The offer or grant of a franchise by a franchisor is exempt if the franchisor:

(1) Has a net equity, according to its most recently audited financial statements, of not less than \$15,000,000 on a consolidated basis, or \$1,000,000 and is at least 80% owned by a corporation or entity that has a net equity, on a consolidated basis, according to its most recently audited financial statements, of not less than \$15,000,000, and the 80% owner guarantees the performance of the franchisor's obligations;

(2) Has had at least 25 franchisees conducting the same franchise business at all times during the five-year period immediately preceding the offer or grant; and

(3) Requires an initial investment by the franchisee of more than \$100,000.

b. The exemption set forth in subdivision 3 of this subdivision may be claimed only if the franchisor:

(1) Files a Form EX Notice of Claim of Exemption and other material as set forth in subdivision 7 no later than 10 business days before the offer or grant of any franchise; and

(2) Submits financial statements demonstrating compliance with the conditions set forth in subdivision 3 a (1) of this subdivision.

c. An initial exemption filing and any renewal filing shall expire after a period of one year. The franchisor shall file for a renewal by making an exemption filing if it intends to offer or grant franchises for any additional period annually, at least 10 business days before the expiration of the previously filed Notice of Claim of Exemption.

4. Sophisticated franchisee.

a. The offer or grant of a franchise for which the franchisor requires an initial investment by the franchisee of more than \$1,000,000 is exempt.

b. The exemption set forth in subdivision 4 a of this subdivision may be claimed only if the franchisor files a Form EX Notice of Claim of Exemption and other material as set forth in subdivision 7 below, no later than 10 business days before the offer or grant of any franchise.

c. An initial exemption filing and any renewal exemption filing shall expire after a period of one year. The franchisor must file for a renewal by making an exemption filing if it intends to offer or grant franchises for any additional period annually, at least 10 business days before the expiration of the previously filed Notice of Claim of Exemption.

5. Institutional franchisee.

a. The offer or grant of a franchise to a bank, savings bank, savings and loan association, trust company, insurance company, investment company, or other financial institution, or to a broker-dealer is exempt when the:

(1) Purchaser is acting for itself or in a fiduciary capacity; and

(2) Franchise is not being purchased for the purpose of resale to an individual not exempt under this regulation.

b. The exemption set forth in subdivision 5 a of this subdivision may be claimed only if the franchisor files an initial filing Form EX Notice of Claim of Exemption and other material as set forth in subdivision 7 a below, at least 10 business days before each offer or grant of each franchise.

6. Disclosure requirements.

a. If a franchisor relies upon any of the exemptions set forth in subdivisions 2, 3, 4 or 5, the franchisor shall provide an offering circular complying with 21 VAC 5-110-90, or Federal Trade commission (FTC) disclosure document pursuant to 16 CFR 436, together with all proposed agreements relating to the grant of the franchise to a prospective franchisee at the earlier of:

(1) The prospective franchisee's first personal meeting with the franchisor; or

(2) Ten business days before the signing of the agreement or the payment of any consideration.

b. Franchisors filing a claim of exemption under subdivisions 3, 4 or 5 shall include a self-addressed stamped envelope by which the commission may return to the franchisor a confirmation of receipt of the filing and the exemption file number assigned. Correspondence shall refer to the assigned file number in all subsequent related filings and correspondence with the commission.

7. Filing requirements for exemptions set forth in subdivisions 3, 4 and 5, above.

a. Initial exemption filing.

(1) The initial exemption period shall expire after a period of one year.

(2) Franchisor files an application for exemption of a franchise by filing with the commission no later than 10 business days before the offer or grant of any franchise, the following completed forms and other material:

(a) Franchise Exemption Application, Form EX;

(b) Uniform Consent to Service of Process, Form D;

(c) If the applicant is a corporation or partnership, an authorizing resolution is required if the application is verified by a person other than applicant's officer or general partner;

(d) Uniform Franchise Offering Circular or FTC disclosure document pursuant to 16 CFR 436;

(e) Files an undertaking by which it agrees to supply any additional information the commission may reasonably request; and

(f) Application fee of \$500 (payable to the "Treasurer of Virginia").

b. Amendment to exemption filing.

(1) Upon the occurrence of a material change, the franchisor shall amend the effective exemption filed at the commission.

(2) An application to amend a franchise exemption is made by submitting the following completed forms and other material:

(a) Franchise Exemption Application, Form EX;

(b) One clean copy of the amended Uniform Franchise Offering Circular or FTC disclosure document pursuant to 16 CFR 436; and

(c) Application fee \$100 (payable to the "Treasurer of Virginia").

c. Renewal exemption filing.

(1) A franchise exemption expires at midnight on the annual exemption effective date. An application to renew the franchise exemption shall be filed 10 days prior to the expiration date in order to prevent a lapse of exemption under the Act.

(2) An application for renewal of a franchise exemption is made by submitting the following completed forms and other material:

(a) Franchise Exemption Application, Form EX;

(b) One clean copy of the Uniform Franchise Offering Circular or FTC disclosure document pursuant to 16 CFR 436; and

(c) Application fee of \$250 (payable to the "Treasurer of Virginia").

NOTICE OF CLAIM OF EXEMPTION

DATE _____

File # _____

FEE: _____

APPLICATION FOR (Check only one):

_____ INITIAL FILING

_____ RENEWAL FILING

_____ AMENDMENT FILING

APPLICATION TYPE (Check only one):

_____ SEASONED FRANCHISOR

_____ SOPHISTICATED FRANCHISEE

_____ INSTITUTIONAL FRANCHISEE

1. Name of Franchisor:

Name of Franchise:

2. Franchisor's principal business address:

3. Name, address and telephone number of sub franchisors, if any, for this state:

4. Name, address, telephone number, and e-mail of person to whom communications regarding this application should be directed:

The undersigned franchisor represents that it:

- (1) Shall provide prospective purchasers in the Commonwealth of Virginia an offering circular that complies with 21 VAC 5-110-90, or an FTC disclosure document (16 CFR 436, as amended July 1, 2007), at least 10 business days prior to the signing of an agreement or receipt of consideration; and*
- (2) Has not been found by a court to be in violation of state or federal franchising or consumer protection laws in the past seven years.*

In addition, if claiming the Seasoned Franchisor exemption, the undersigned represents that it:

(1) (Check the applicable box)

() Has a net equity on a consolidated basis, according to its most recent audited financial statement, of not less than \$15,000,000;

Or

() Has a net equity of \$1,000,000 according to its most recent audited financial statement and is at least 80% owned by a corporation or other entity which has a net equity on a consolidated basis, according to its most recent audited financial statement, of not less than \$15,000,000 and the owner guarantees the performance of the franchisor's obligations;

(2) Has had at least 25 franchisees conducting the same franchised business at all times during the five-year period immediately preceding the offer or sale; and

(3) Requires a minimum investment of more than \$100,000.

Attach a copy of the franchisor's most recent Uniform Franchise Offering Circular or an FTC disclosure document (16 CFR 436, as amended July 1, 2007) and, if applicable, financial statements of any corporation the franchisor is relying on to qualify for the exemption.

This claim of exemption, other than sales to an Institutional Franchisee, will be effective for a period of 12 months from the date it is granted. A renewal notice should be filed 10 business days prior to the expiration of the effective period.

Certified this _____ day of _____, 20_____

By _____
Signature

Type or Print Name and Title

For

Type or Print Name of Franchisor

ESCROW AGREEMENT

This Escrow Agreement, made this ____ day of _____, by _____ organized under the laws of the State of _____, (hereinafter referred to as "Franchisor") and _____ organized under the laws of the State of _____ (hereinafter referred to as "Bank").

WHEREAS, the Franchisor desires to offer and sell franchises in the Commonwealth of Virginia, and

WHEREAS, it is the discretion of the Virginia State Corporation Commission (the "Commission") as Administrator of the Virginia Retail Franchising Act, to require an escrow of franchise fees and other fees paid by the franchisee to the Franchisor, and

WHEREAS, in order to conform to the procedures for arranging an escrow account, the Franchisor desires to enter into an Escrow Agreement with the Bank, pursuant to which franchise fees and other fees are to be held in escrow for the purpose of complying with the Virginia Retail Franchising Act.

NOW, THEREFORE, with the foregoing recitals hereinafter incorporated by reference and made a part hereof, it is agreed as follows:

1. The Franchisor shall, until release of escrowed funds as hereinafter provided, deposit with the Bank, all monies obtained from each franchisee that contracts to operate the franchised business within the Commonwealth of Virginia.

2. All funds delivered by the Franchisor to the Bank will be placed in a separate account designated substantially as follows: _____

3. The Bank shall pay out funds, plus interest if any, from the Escrow Account only upon the occurrence of one of the following conditions:

a. A letter from the President or Secretary of the Franchisor directing the Bank to pay out such funds to _____ accompanied with a written notice from the Commission stating that it takes no exception to the release of such funds to _____.

b. Upon written notice from the Commission, the Bank shall return the deposited franchise fees and other fees to a specific franchisee.

c. The Bank shall pay funds into court or disburse or deliver them in accordance with any order of any court of competent jurisdiction.

4. The Franchisor will supply the Bank with the name and address of each franchisee, together with the amount of the deposit that represents each franchisee's franchise fees and other fees, and the Bank will retain records containing the same information.

5. Any funds deposited in the Escrow Account pursuant to this Escrow Agreement shall be invested and kept invested by the Bank in obligations of the United States, or a savings

account or savings accounts of the Bank, or money market funds of or available to the Bank and to which the Bank or an affiliate is investment advisor or provides other services and receives reasonable compensation for such services, provided the money market funds are rated AAAM by Standard and Poor's and Aaa by Moody's Investor Services, or U.S. Treasury Bills, Notes or Bonds until such funds are to be disbursed as provided in Paragraph 3 hereof. All interest received and any increment shall be added to the funds so deposited in the Escrow Account and shall be distributed as provided in Paragraph 3 hereof.

6. The Commission may inspect the records of the Bank, insofar as they relate to this Escrow Agreement, for the purpose of determining compliance with and conformance to the provisions of this Escrow Agreement. At the Commission's discretion, statements indicating the status of escrow shall be furnished by the Bank to the Commission.

7. The Franchisor shall pay to the Bank reasonable compensation for expenses incurred and services rendered by the Bank under this Escrow Agreement.

8. The Bank shall have no duty to determine the propriety of any deposit or disbursement of funds. Additionally, the Bank shall have no duty to the Franchisor, the Commission, any franchisee or any other party except as expressly stated in this Escrow Agreement. The Franchisor does hereby indemnify the Bank from any and all costs, claims and expenses, including attorneys' fees, which may be incurred by or which may accrue to the Bank relating to the opening or maintenance of any account established under this Escrow Agreement.

9. All proceeds deposited pursuant to this Escrow Agreement shall not be subject to any liens or charges by the Bank, or judgments or creditor's claims against the Franchisor.

10. The Franchisor shall give each franchisee a copy of this Escrow Agreement prior to collecting any funds from that franchisee.

11. The Bank's duties under this Escrow Agreement shall terminate upon final distribution of all monies deposited as provided hereunder.

12. This Escrow Agreement is governed by the laws of the Commonwealth of Virginia.

IN WITNESS WHEREOF, each party has caused this Escrow Agreement to be signed and executed, and its corporate seal hereto affixed, in its name by its proper and fully authorized officer or officers on the day and year first above written.

ATTEST:

NAME AND ADDRESS OF BANK

(Bank's Secretary)

By: _____

Title: _____

NAME AND ADDRESS OF FRANCHISOR

(Franchisor's Secretary)

By: _____

Title: _____

ESCROW INSTRUCTION SHEET

- A. The Franchisor must return a fully executed copy of the escrow agreement, with original signatures, to the Division of Securities and Retail Franchising before its application will be made effective.
- B. The Franchisor must also provide to the Division in writing, the name of the bank, the name, address and telephone number of the person(s) at the bank who may be contacted for information regarding the escrow account, and the account number. Any changes to this information should be immediately provided to the Division.
- C. Funds in the escrow account will only be released upon completion by the Franchisor of its pre-opening obligations to the Franchisee. Requests for the release of escrowed funds should be in writing and should be sent to the Division. The Franchisor should state in the request the exact amount of the funds to be released. The Division must receive written certification from the Franchisee whose funds are to be released to the Franchisor. The certification should state the amount of funds to be released, and that the Franchisor's pre opening obligations to the Franchisee have been satisfied.
- D. Please refer to 21 VAC 5-110-65 of the Virginia Administrative Code, entitled "Escrow and Deferral", for additional information on the operation of escrow accounts.